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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

ANNUAL COMPLIANCE REVIEW, 2013	Docket No. ACR2013

RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
QUESTIONS 1-3.b, 4-5, AND 7-12 OF CHAIRMAN'S INFORMATION REQUEST NO. 5

The United States Postal Service hereby provides its responses to the above-listed questions of Chairman's Information Request No. 5, issued on February 3, 2014. Each question is stated verbatim and followed by the response. Responses to questions 3.c and 6 are still under preparation.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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1. The following question concerns the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 product, which is comprised of a number of negotiated service agreements (NSAs) governing the entry of inbound letter-post. Please refer to the market dominant multi-service agreements that were the subject of Docket Nos. R2010-5, R2013-4 (Royal PostNL (Netherlands)); R2012-5 (Canada Post); R2013-3, R2012-4 (Hong Kong Post); R2011-7 (China Post); and R2012-2 (Australian Postal Corporation). *See* USPS-FY13-NP2, the Excel files "NSA Summary (Booked).xls" and "NSA Summary (Imputed).xls", worksheet tabs Summary.

In its Notices in the above-referenced dockets, the Postal Service asserts that the negotiated rates in each of the multi-service agreements "result[] in improvement over [the] default rates established under the Universal Postal Union (UPU) Acts for inbound letter-post items."[1] Please confirm that for the actual volumes entered pursuant to the referenced multi-service agreements during FY 2013, the negotiated rates improve the cost coverage of such agreements compared to the cost coverage at the UPU terminal dues rates. If not confirmed, please explain. Please identify in library reference USPS-FY13-NP2 (*e.g.,* FY 2013 International Cost and Revenue Analysis (ICRA) report) the financial analysis relied upon by the Postal Service to support your response, or provide such financial analysis if not presented in the FY 2013 ICRA or elsewhere in the (ACR).

[1] For example, Docket No. R2012-2, Notice of United States Postal Service of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement, October 14, 2011, at 1.

RESPONSE:

The Postal Service confirms that for the actual volumes entered pursuant to the referenced multi-service agreements during FY 2013, the negotiated rates improve the cost coverage of such agreements compared to the cost coverage at the UPU terminal dues rates. Please see ChIR.5.Q.1 – Inbound MD reporting.xls, filed under seal as part of USPS-FY13-NP35, that accompanies this response for the requested financial analysis.

2. The following questions concern inbound Express Mail Service (EMS) and the Kahala Posts Group (KPG).

(a) Please identify the foreign postal operators that were members of the Kahala Posts Group during FY 2013, and which of those member posts entered inbound EMS into the U.S.

(b) Please confirm that during FY 2013, the EMS Cooperative Pay-for-Performance Plan was applicable to all KPG members identified in your response to subpart (a), above. If not confirmed, please identify KPG member posts were not subject to the EMS Cooperative Pay-for-Performance Plan and explain why the EMS Cooperative Pay-for-Performance Plan was not applicable to all KPG member posts.

(c) The KPG Strategic Services Agreement contains the conditions for date-certain delivery performance in which late delivery results in penalties in the form of a postage refund. *See* Response to CHIR No. 4, question 12(b), Docket No. ACR2012. Please provide any fiscal year, calendar year, and quarterly reports that measure the service performance of inbound EMS from KPG member posts with respect to late deliveries, penalties and any other service performance metrics. If there are no such reports, please provide the number of late deliveries for which a postage refund was made and the total amount of such refunds in FY 2013 for each KPG member post.

(d) Please identify where in library reference USPS-FY13-NP2 or elsewhere in the ACR that the FY 2013 "booked" and "imputed" financial results for inbound EMS entered by KPG member posts can be found, or provide such financial results if they are not presented in the FY 2013 ICRA or elsewhere in the ACR.

RESPONSE:

(a) The Kahala Posts Group members in FY2013 were: The United States Postal Service, Australian Postal Corporation, China Post Group, Correos Y Telégrafos SAE, Groupe La Poste, Hongkong Post, Japan Post Service Co., Ltd, Korea Post, Royal Mail Group Ltd, and Singapore Post Limited. All of the previously referenced foreign postal operators who were members of the Kahala Posts Group in FY 2013 entered EMS into the United States in FY2013.

(b) During FY2013, the EMS Cooperative Pay for Performance Plan was applicable to the following KPG members: Great Britain, Hong Kong, Japan, Korea, Singapore, and United States. In FY 2013, the EMS Cooperative Pay for Performance Plan was not applicable to the following KPG members: Australia, China, France, and Spain. The EMS Cooperative Pay-for-Performance was not applicable to the aforementioned countries, because those countries opted not to participate in the EMS Pay-for-Performance Plan with the Postal Service.

(c) Please see ChIR.5.Q.2c—Inbound EMS KPG reporting.pdf, filed under seal as part of USPS-FY13-NP35, that accompanies this response.

(d) Please see ChIR.5.Q.2d – Kahala reporting.xls, filed under seal as part of USPS-FY13-NP35, that accompanies this response.

3. Inbound Air Parcel Post (at non-UPU rates) consists of financial results for Royal Mail and collectively for several European postal operators that have executed bilateral agreements pursuant to Annex B2 of the EPG agreement, which predates the PAEA. For FY 2013, the Booked version of the ICRA reports a loss for Inbound Air Parcel Post (at non-UPU rates) caused solely by the financial results of inbound air parcels from EPG postal operators. However, the FY 2013 loss is substantially less than the FY 2012 loss.

During FY 2013, the Postal Service implemented a "performance action plan" making operational improvements affecting EPG parcels to decrease penalty payments and increase revenue. *See* Response No. 4, Postal Service Responses to ACD Request, Docket No. ACR2012, June 26, 2013.

(a) Please describe the features of the performance action plan, identify the operational improvements implemented, and explain how the improvements decreased penalty payments and increased revenues during FY 2013.

(b) Please describe the conditions during FY 2013 that caused the Postal Service to make penalty payments, and explain whether penalty payments arose from the bilateral agreements executed pursuant to Annex B2 of the EPG agreement, or obligations arising from other bilateral or multilateral agreements.

(c) Please provide any fiscal year, calendar year, and quarterly reports that measure the service performance of inbound air parcels from EPG postal operators with respect to penalty payments and any other service performance metrics. If there are no such reports, please provide the total penalty payments and the number of delivery or other events that caused a penalty payment during FY 2013 and FY 2012.

RESPONSE:

(a) In December 2012, the Postal Service developed an EPG continuous improvement plan for performance and service commitment. The Postal Service requested other EPG operators to sign a new Annex B3 (version 4) in an attempt to align the USPS international operational framework better with domestic network changes. Key features of the plan included the following: International Service Center (ISC) alignment with domestic network service standards, increased operational capacity, and operational process optimization.

The Postal Service set goals for each calendar quarter of 2013, with On-Time Performance improvements expected in each quarter. Then International Network Operations worked with each of the ISCs to focus on issues unique to it to achieve improved performance. These initiatives included assignment of a Lean Six Sigma team to one ISC's operations, weekly service teleconferences focused on priority service, facility renovation, additional equipment installation for parcel sortation, item level scanning improvement, and consolidation of the military mail operations to one ISC.

The Postal Service is not able to directly connect any one of these initiatives with the reduction in penalties and increased revenue it has observed for EPG-related products, but the results are recorded with an on-time delivery percentage improvement from October 2012 to October 2013 of nearly 30 percent. This improvement of on-time deliveries reduces the number of pieces subject to penalty payments.

(b) Notable conditions in FY 2013 that may have had an impact on penalties included effects from Hurricane Sandy on operations at the JFK ISC. Disruption from the consolidation of the military mail operations into a single facility may also have initially resulted in a service level drop, but the overall effect of the consolidation is believed to have been positive.

(c) The Postal Service anticipates being able to provide information responsive to this request, but is unable to do so at this time.

4. The following question concerns the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. Please refer to the competitive multi-service agreement that is the subject of Docket No. CP2011-68 (China Post). *See* USPS-FY13-NP2, the Excel files "NSA Summary (Booked).xls" and "NSA Summary (Imputed).xls", worksheet tabs Summary. Please explain why costs exceeded revenues for both the Booked and Imputed versions.

RESPONSE:

CP2011-68 (covering EMS, SCP and ACP) was only reported during Quarter 1 of FY13, after which the agreement expired. USPS-FY13-NP2, the Excel files "NSA Summary (Booked).xls" reported unit costs 10.5 percent lower and unit revenue 15.0 percent lower than projected in CP2011-68. USPS-FY13-NP2, the Excel files "NSA Summary (Imputed).xls" reported unit costs 10.5 percent lower and unit revenue 14.5 percent lower than projected in CP2011-68.

5. The following questions concern International Money Transfer Service (IMTS), which consists of an outbound and inbound product.
   (a) The Postal Service reports that costs for the IMTS—Outbound product exceeded revenues in FY 2013. Refer to USPS-FY13-NP2, Excel files "Reports (Booked).xls" and "Reports.xls," worksheet tabs A Pages (c), Tables A-2 in each file. Please identify and explain the factors that caused costs for the IMTS—Outbound product to exceed revenues.
   (b) For FY 2013, no volume variable or product-specific costs are reported for the IMTS-Inbound product. *See* USPS-FY13-NP2, Excel files "Reports (Booked).xls" and "Reports.xls," worksheet tabs A Pages (c), Tables A-2 in each file. Please explain the absence of FY 2013 volume variable and product-specific costs for the IMTS-Inbound product, and provide them if they are available.
   (c) For the combined IMTS—Outbound and IMTS—Inbound products during FY 2013, please provide the total number of In-Office Cost System (IOCS) tallies, the coefficient of variation (CV) for the IOCS-based cost estimate, and the 95 percent confidence interval for the cost coverage.
   (d) The Postal Service maintains that the use of IOCS tallies to develop IMTS attributable costs is problematic. *See* Response No. 2, Postal Service Responses to ACD Request, Docket No. ACR2012, June 26, 2013. In the absence of IOCS tallies, to what extent could window service costs associated with cashing domestic money orders be used as a surrogate for the window service costs of cashing IMTS—Inbound money orders? In the response, please explain what adjustments (if any) to the window service costs of cashing domestic money orders would be needed to reflect any differences in the costs of cashing IMTS—Inbound money orders.

RESPONSE:

(a) Please refer to USPS-FY13-NP5, FY 2013 ICRA Overview/Technical Description, Chapter 9, Figure 9.1 and USPS-FY12-NP5, FY 2012 ICRA Overview/Technical Description, Chapter 9, Figure 9.1. The main change between the two years was a 96 percent decrease in Outstanding MO Taken Into Revenue.

(b) There were no inbound tallies for IMTS in FY2013.

(c) There were nine tallies for IMTS in FY2013. The coefficient of variation of the IOCS sample-based costs is 34 percent using the generalized variance function approach. The 95 percent confidence interval for the cost coverage is 46 to 146 percent.

(d) For the second consecutive year, there were no IOCS tallies reported for IMTS—Inbound and only nine tallies in total for IMTS. The Postal Service maintains that the use of IOCS tallies to develop IMTS attributable costs is problematic.

In spite of multiple, labor intensive attempts over the course of four years to observe such transactions to record their times and to understand their comparability to domestic money order cashing transactions, the Postal Service has been able to observe only two such transactions. This low rate of observation should not be unexpected, since domestic money order cashing IOCS tallies reported in ACR 2012, for example, numbered only 31 out of the nearly 109 million total domestic money order transactions reported in that year. In 2013, the best information available to the Postal Service indicates that fewer than 100,000 total IMTS transactions occurred. Thus, the Postal Service is unable to suggest what adjustments might be appropriate to the window service costs of cashing domestic money orders to reflect any differences in the costs of cashing IMTS—Inbound money orders.

The Postal Service has some theories about some differences that might make such transactions shorter or longer than domestic money order cashing, and it has attempted to validate these theories, but its efforts have not achieved results. Without validation of any adjustments that could be proposed, the surrogate cost basis would appear to be unreliable.

7. The following question concerns the market dominant product Global Direct Entry with Foreign Postal Administrations. In Docket No. R2013-1, Notice of Market-Dominant Price Adjustment, the Postal Service added a handling charge for foreign origin, inbound direct entry First-Class Mail Machinable Single-Piece Letters, Single-Piece Postcards, Single-Piece Flats, and Single-Piece Parcels tendered by foreign postal operators, subject to the terms of an "authorization arrangement." The handling charge took effect January 27, 2013.

(a) Please identify the foreign postal operators that entered foreign origin, inbound direct entry items pursuant to an authorization arrangement during FY 2013.

(b) Prior to Commission regulation of market dominant products pursuant to the PAEA, the Postal Service concluded arrangements for Global Direct Entry with eight foreign postal operators. Please identify and explain whether any of the pre-PAEA arrangements were superseded by an authorization arrangement during FY 2013.

(c) Please refer to Library Reference USPS-FY13-NP2, Excel file "Reports (Booked).xls," worksheet tab A Pages (c), Table A-2 and provide the financial results for Global Direct Entry with Foreign Postal Administrations shown in Table A-2 separately for foreign postal operators that entered Global Direct Entry items pursuant to pre-PAEA arrangements and authorization arrangements concluded during FY 2013.

RESPONSE:

(a) The foreign postal operators that entered foreign origin, inbound direct entry items pursuant to a pre-PAEA authorization arrangement during FY 2013 were Swiss Post and Singapore Post.

(b) None of the pre-PAEA authorization arrangements were superseded by agreements in FY2013. Between January 15 and January 24, 2014, the Postal Service provided draft inbound direct entry agreements to seven foreign postal operators for their consideration. These agreements are expected to supersede all pre-PAEA authorization arrangements.

(c) All of the financial results shown at Library Reference USPS-FY13-NP2, Excel file "Reports (Booked).xls," worksheet tab A Pages (c), Table A-2 for

Global Direct Entry with Foreign Postal Administrations are for pre-PAEA arrangements.

8. Please refer to the Preface to Library Reference USPS-FY13-NP27, which shows that costs exceeded revenue for Officially Licensed Retail Products (OLRP) in FY 2013.

(a) Please explain why the OLRP did not cover attributable costs.

(b) Please identify specific causes for the 171 percent increase in costs from FY 2012.

(c) Please provide a breakdown of the offerings included as OLRP.

RESPONSE:

a.-b. Essentially, this is a timing issue. Delivery of OLRP inventory that was intended to be purchased in late FY12 was unexpectedly delayed, and therefore these inventory expenses appeared on the books in FY13. This delay had two effects – reported FY12 inventory costs were lower than otherwise would have been the case, and reported F13 inventory costs were higher. Not surprisingly, as a result, comparing the two years, inventory costs in FY13 were higher than in FY12 , leading to the observed overall SPLY cost increase noted in the question. Because of these timing effects, focusing just on FY13 masks the more accurate assessment which can be made by aggregating results (costs, revenues and contribution) over the combined two-year period of FY12-FY13, using the information in USPS-FY12-NP27 and USPS-FY13-NP27. Smoothing the data in this simple way, over the combined two years, aggregate revenues exceeded aggregate costs by a comfortable margin. The Postal Service has no reason to expect such timing issues to reoccur, and thus expects to revert to the more customary favorable revenue/cost relationship in FY14.

c.. The current OLRP Product Offering are:

1.Digital Postage Scales
2.Passport Holders
3.Stamp Coil Dispenser
4.Click-N-Ship Shipping Labels

9. Please refer to Library Reference USPS-FY13-3, USPS-FY13-3.Workshare[1].zip, workbook FY13.3.Worksharing Discount Table_Final.xlsn, tab "FCM Bulk Letters, Cards."

(a) Please confirm that the Postal Service did not provide a calculation of workshare passthroughs for the First-Class Mail Automation AADC Letters and the First-Class Mail Automation AADC Cards categories. If not confirmed, please explain.

(b) If part (a) is confirmed, please provide passthrough calculations for First-Class Mail Automation AADC Letters and First-Class Mail Automation AADC Cards. [Note: Docket No. RM2012-6, which established a new benchmark for the calculation of workshare passthroughs for Automation 5-Digit Letters and Automation 5-Digit Cards, made no adjustments to the calculation of passthroughs for the AADC categories.]

(c) If either passthrough calculated in part (b) exceeds 100 percent, please identify an applicable exception in 39 U.S.C. § 3622(e)(2)(B) and provide a justification supporting the statutory exception.

RESPONSE:

(a) Confirmed that the Postal Service did not provide a separate workshare passthrough for AADC Letters or Cards separately, but instead presented the passthroughs for the combined AADC and 3-Digit Letters category.

(b) The Postal Service believes that weighted average of AADC/3-Digit costs should be used not only as a benchmark for the calculation of 5-Digit prices, but also for the calculation of AADC/3-Digit prices. The logic that is used in the first instance can and should be used for the derivation of AADC/3-Digit prices. It makes no sense to have a different cost avoidance for AADC than for 3-Digit, when they represent just one price cell. Using only AADC cost avoidance for this price cell ignores the 3-digit cost avoidance. If you use the weighted average, the passthrough for automation letters is 95.5 percent. Using the weighted average, the passthrough for automation cards is 92.3 percent. Therefore, no exception is required for either letters or cards using the weighted average method.

Letters:

If we were to use only the AADC Automation Letters cost avoidance instead of the weighted average, then the passthrough is 105 percent. This particular passthrough was 100 percent in the last two price change dockets, but an abrupt drop in the cost avoidance from 2.6 cents to 2 cents has caused this passthrough to exceed 100 percent.

Cards:

Using the cost avoidance for only AADC, the passthrough for AADC Automation Cards is 109.1 percent. This is mainly because the cost avoidance declined from 1.3 cents to 1.1 cents.

(c) The Postal Service continues to believe that the weighted average is the appropriate cost avoidance benchmark. However, if the cost avoidance remains at the unweighted AADC level, the Postal Service intends to align each of these discounts with the most recently estimated cost avoidance at the time of the next general rate adjustment. This assumes that this alignment is consistent with the level of CPI and the business strategy needs at the time of the price change filing.

10. In Response to CHIR No. 2, question 3, the Postal Service explains that Parcel Select (non-NSA) unit costs increased in FY 2013 compared to FY 2012 due to increases in the costs for heavyweight Parcel Select, specifically increases in the Parcel Select Non-Presort category. The Postal Service further explains that it is likely that costlier former market dominant Parcel Post pieces have migrated to Parcel Select Nonpresort instead of the Standard Post product. Given this migration and the fact that Parcel Select (non-NSA) did not cover costs in FY 2013, please explain how the Postal Service plans to ensure that Parcel Select (non-NSA) revenues will cover attributable costs in future years.

RESPONSE:

With the revisions to the ACR that were filed on February 6, 2014, Parcel Select (non-NSA) does cover attributable costs, and the Postal Service expects it will continue to do so in future years.

11. The following questions refer to Parcel Select Contract 4 (Docket Nos. MC2013-46/CP2013-60), which appears to have not covered costs in FY 2013. The Postal Service explains that the transportation costs proxy used in the contract's costing model appears anomalous.

(a) Please explain if there are other reasonable proxies or adjustments that the Postal Service could use to identify unit transportation costs for Parcel Return Service Contract 4 and future Parcel Return Service Full Network NSAs.

(b) Please explain how the Postal Service will ensure that revenues for Parcel Return Service Contract 4 will cover costs in future fiscal years.

RESPONSE:

a,b) The cost model for Parcel Return Service Full Network NSAs used Parcel Select Non-presort as a proxy. When Parcel Return Service Contract 4 was originally filed, the average size and weight of Parcel Select Non-presort was approximately equivalent to the customer's parcels. With the migration from former Parcel Post pieces[1], Parcel Select Non-Presort became much larger and heavier than in FY2012. The costing methodology should be changed to allow an adjustment for the customer's characteristics relative to the now-changed proxy, and it appears a reasonable adjustment exists to do so. The Postal Service will request a rulemaking to obtain approval for the methodology change. This should enable Parcel Return Service Contract 4 to cover its costs in future years.

[1] See NOTICE OF THE UNITED STATES POSTAL SERVICE OF REVISIONS TO THE FY2013 ANNUAL COMPLIANCE REPORT – ERRATA, February 6, 2014, pp. 1-2.

12. Please provide revenue, volume, weight, and attributable costs data for the following 24 competitive domestic NSA products similar to the data for other competitive domestic NSA products filed with Library Reference USPS-FY13-NP27. If the data are not available, please explain.

	Competitive Domestic NSA Product	MC Docket	CP Docket
1	Parcel Select Contract 7	MC2013-59	CP2013-80
2	Priority Mail Contract 7	MC2009-25	CP2009-31
3	Priority Mail Contract 13	MC2009-29	CP2009-39
4	Priority Mail Contract 14	MC2009-30	CP2009-40
5	Priority Mail Contract 20	MC2010-02	CP2010-2
6	Priority Mail Contract 21	MC2010-03	CP2010-3
7	Priority Mail Contract 22	MC2010-04	CP2010-4
8	Priority Mail Contract 26	MC2010-31	CP2010-76
9	Priority Mail Contract 32	MC2011-11	CP2011-47
10	Priority Mail Contract 35	MC2011-18	CP2011-57
11	Priority Mail Contract 36	MC2012-2	CP2012-6
12	Priority Mail Contract 47	MC2013-7	CP2013-7
13	Priority Mail Contract 54	MC2013-37	CP2013-48
14	Priority Mail Contract 56	MC2013-42	CP2013-55
15	Priority Mail Contract 58	MC2013-47	CP2013-61
16	Priority Mail Contract 61	MC2013-55	CP2013-73
17	Priority Mail Contract 62	MC2013-56	CP2013-74
18	Priority Mail Express Contract 6	MC2010-6	CP2010-6
19	Priority Mail Express Contract 7	MC2010-7	CP2010-7
20	Priority Mail Express Contract 9	MC2011-1	CP2011-2
21	Priority Mail Express Contract 10	MC2011-12	CP2011-48
22	Priority Mail Express and Priority Mail Contract 10	MC2012-54	CP2012-66
23	Priority Mail Express and Priority Mail Contract 14	MC2013-58	CP2013-79
24	Priority Mail Express, Priority Mail, & First-Class Package Service Contract 1	MC2012-46	CP2012-55

RESPONSE:

All but three of the contracts listed had no mail shipped during FY2013, so revenue, weight and costs are zero. The three contracts with some mail were only active for a portion of one month of the fiscal year, either in October of 2012 or September of 2013, and in these instances all three mailers had another contract in effect for the remainder of FY2013. For each of these three contracts, the small amount of mail that was shipped at the very beginning or the very end of the fiscal year was instead reported in the corresponding contract with the same mailer that was in effect for over eleven months in FY2013.